IN THE

Supreme Court of the United States

October Term, 1959

No. 808

CERTAIN INTERESTS IN PROPERTY IN CHAMPAIGN COUNTY, STATE OF ILLINOIS; CHANUTE GARDENS CORPORATION and CHANUTE APARTMENTS CORPORATION,

Petitioners,

v.

UNITED STATES OF AMERICA.

ON PETITION FOR A WRIT OF CERTIORARI TO UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

REPLY BRIEF OF PETITIONERS.

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This Brief is submitted in reply to the Brief for the United States in opposition to our petition for certiorari.

I. The *Benning* Case.

The decision of the Fifth Circuit in *United States* v. *Benning Housing Corp.* (C. A. 5, No. 17726, decided March 25, 1960), printed in full in the Government's Brief, furnishes added reasons for the granting of certiorari here.

A. The Court in *Benning*, rejecting reproduction cost as an element of value in Wherry project cases, held that even where there were a few isolated comparable sales,[1]

[1] One of the sales held comparable in *Benning* was of the Wherry project at Fort Devins, Mass. (see fn. 2 to opinion). But it was this same sale which was held non-comparable by the courts below in the case at bar (see our Pet. for Cert., p. 15a), it being a sale of stock in a corporation owning a Wherry project. (*Id.* at p. 14, fn. 4.) We suspect that the other two sales mentioned in *Benning* were of a similarly inadmissible nature.

(missing here), it did not constitute a market. The Court in *Benning* carefully avoided using the standard of market value used by the Court below in the case at bar.[2] Moreover, *Benning* rejected reproduction cost not on the ground that the property was not sufficiently unique (as did the Court below here), but for entirely different reasons.

B. *Benning* contributes a fifth view to four already-existing different views on the treatment of reproduction cost in cases where there is no established market value and where property is taken to continue its same governmental use.

(i) Both *Benning* and the decision below conflict squarely with *In re United States Commission to Appraise*

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[2] The Government contends that the conflict between the Executive, Legislative and Judicial Departments can be resolved on the basis that the Wherry Act did not contemplate its sponsors would cover reproduction cost, relying upon *Benning*. However, it would seem that *Benning* ignored the later Capehart Act, which provided for a maximum negotiated price of a reproduction cost less depreciation. Though this negotiated price was of course not necessarily applicable in condemnation proceedings, the fact does remain that Congress and the Executive Departments have determined that the application of the usual rule of fair market value would be an "improper and grossly unfair" measure of just compensation for Wherry projects, and that this "improper and grossly unfair" rule was used below in the case at bar.

The quest for a market value below resulted in an entirely disproportionate weight being given to the figure arrived at for capitalization of rents. The final valuation figure of the Court was $7,100,000—only 2% above the court-found capitalized value ($6,950,000)—but some 21% less than net reproduction cost ($8,750,000) or some 23% less than original reasonable cost ($9,200,000). (And this for properties which were in even better condition than when originally built!)

It is thus apparent that the Trial Court relied almost entirely if not exclusively upon capitalization of rents. Had it been seeking true value, or sound value, rather than a non-existent market value, it is patent that the same result would not have followed, but that more weight would have been given to other elements besides capitalization of rents. See pet. for cert., p. 22, fn. 11.

Washington Market Co. Property, 295 Fed. 950 (D. C. Cir., 1924), *pet. for cert. dismissed on Government's motion*, 265 U. S. 598. While *Benning* seeks to distinguish *Washington Market* (which placed *exclusive* reliance on reproduction cost) on the theory that it did not involve leases at nominal rentals and Government-insured mortgages, such a consideration is entirely irrelevant to the *ratio decedendi* of *Washington Market*, where reproduction cost was used as the exclusive test (even though there was evidence of market value—see 295 Fed. at 959), solely and simply because the property was taken to continue its use and because market value therefore did not represent just compensation. That reproduction cost is not the measure of value solely because of *ab initio* inducements seems to be a non-sequitur. The test of *Washington Market* is whether the property was taken to continue its use.

(ii) In relying on the so-called inducements and on rent control as the reasons for rejecting reproduction cost, *Benning* squarely conflicts with *Thayer-West Point Hotel Co.* v. *United States*, 64 F. Supp. 565 (Ct. Cls. 1946), modified on other grounds, 329 U. S. 585. In *Thayer*, even greater inducements were present than in the case at bar—the lessee there paid a ground rent of $1 for the entire 50 year term (R. 6). And rents were controlled arbitrarily by the military. Yet neither the Solicitor General nor this Court saw any reason to object to main reliance being placed on reproduction cost.

(iii) *Benning* concedes there was no established market value. Where there is "no open market and no comparable sales to serve as proof * * * of market value", the Second Circuit has held that "under such conditions * * *, reproduction cost less proper depreciation may be deemed a reliable indication of the *minimum* value." *The Hisko*, 54 F. 2d 540, 541 (2d Cir., 1931) (emphasis supplied). *Benning* holds that under such circumstances, reproduction cost sets a *maximum* value—and cannot even be considered.

C. The decisions below here held that, in ascertaining capitalized value, the actual rentals—based upon estimated anticipated cost rather than actual original cost—must be capitalized. We contended unsuccessfully that we were entitled to have rentals capitalized which were based on original cost. *Benning* accepts our contention, and thus conflicts with the decisions below.[3]

D. *Benning* holds that valuation must be based upon comparable sales, capitalization of income, and original cost. In the case at bar, there were no comparable sales, and there was no actual consideration given to original cost (see fn. 2 *supra*). Had the rents allowable under *Benning* been capitalized instead of the illegal rentals which were capitalized, a capitalized value of some $9,200,000 and an original cost of the same amount would have been the only two factors considered in determining value; the award here of $7,100,000 would then have been inconceivable.

E. Another point of departure of *Benning* is its predication of the right to recover reproduction cost upon complete ownership, reasoning that a long-term lessee who possesses the full value of the fee is in the same position as a licensee who must remove his improvements upon notice (fn. 9, *Benning*). Not only is the analogy altogether unconvincing, but it simply does not follow that one subject to reasonable rent regulation who has been granted inducements for making a bargain is *ipso facto* deprived of complete ownership. Under this novel theory, every property subject to federal, state or municipal rent regulation, or which has been built with public assistance, is thereby not completely owned and reproduction cost can not be even an element in its valuation.

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[3] In our case, since there was only a one-half of one per cent variation between original cost ($9,200,000) and reproduction cost ($9,250,000), rentals based upon original cost would have yielded a capitalized value closely approximating reproduction cost. The rentals used by the courts below resulted in a capitalized value of $6,950,000.

F. In using capitalized value as a test for Wherry projects, and in holding that increased construction costs on a sharply rising market cannot be considered, *Benning* necessarily falls into the same error as the Courts below and the Government's witnesses: that the Wherry investor loses a substantial part of his investment immediately upon completion.[4]

The illogical conclusion demonstrates the fallacy of its premises, a fallacy due to the resort to an outside market to get a capitalization rate (Pet. App. 112a), when there is no market to provide a proper capitalization rate, and when the property was specifically constructed on a non-marketable basis.

But in any event, the alarm of inflation cannot be rung here, for the increase in reproduction cost over original cost was less than 3% in the case at bar. Inflation cannot explain the valuation here at some 23% less than original cost or some 21% less than even net reproduction cost.

G. *Benning* requires a showing that "substantial reproduction would be a reasonable business venture" before reproduction cost be considered. What this means is that the property must possess present utility and be not obsolete—which is the precise holding of the case upon which *Benning* relies for this proposition (*United States* v. *Wise*, 131 F. 2d 851 (4th Cir., 1942)). Here the Government has taken the property to continue the same use, and has built substantially similar housing at the same base at greater cost; and only the Government could build such property. See also, Petition for Certiorari in the case at bar, pages 24-25. We amply meet this condition of *Benning*.

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[4] Government witnesses so testified. Our point is made by this example: assume an estimated and actual original cost of $1,000,000, with the 6½% return negotiated here yielding a $65,000 return. Capitalize this at the increased outside market rate of 8%, and the resulting value is $812,500. Thus, the value of the project under the theory in *Benning* has declined some 18¾% immediately upon its construction.

II. The "Subject to the Mortgage" Problem.

Government's Brief itself notes that whereas the taking occurred on May 1, 1957, the petitioners were not released from their obligations on the mortgage notes until April 14, 1958 (pp. 5-6). Thus, for almost a year, when twelve monthly mortgage payments became due, petitioners were liable for payment on the mortgage notes under the theory of the Court below that petitioners' interests were taken subject to the mortgage.

Respectfully submitted,

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